IT 01-0060-GIL 08/02/2001 SUBTRACTION MODIFICATIONS – PENSIONS

General Information Letter: Military retirement pay is not subject to Illinois income taxation.

August 2, 2001

Dear:

This is in response to your letters dated August 11, 2001 which were received by the Illinois Department of Revenue on July 30, 2001, in which you request that the Illinois Department Of Revenue provide responses to your questions concerning the Illinois tax treatment of military annuity payments and military retirement payments.

According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL"). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill.Adm.Code §1200, or on our website http://www.revenue.state.il.us/legalinformation/regs/part1200.

Due to the nature of your inquiry, we are required to respond with a GIL. GILs are designed to provide information on specific topics. GILs, however, are not binding on the Department and do not constitute a statement of policy that applies, interprets or prescribes tax law. It is not binding on the Department.

In your first letter, you state:

> Title 10, United States Code authorized three survivorship annuity plans under which retired military personnel (and uniformed personnel of the Public Health Service and National Oceanic and Atmospheric Administration) may provide for payments of annuities to their surviving spouses or dependent children by electing to receive a reduced rate of retired pay during their own lifetime. Subchapter I (10 U.S. Code 1431-1446) is the Retired Serviceman's Family Protection Plan (RSFPP) (formerly the Uniformed Services Contingency Option Act of 1953); Subchapter II (10 U.S. Code 1447-1455) covers the Survivor Benefit Plan (SBP) (P.L. 92-425); and Subchapter III (10 U.S. Code 1456-1460) covers the Supplemental Survivor Benefit Plan (SSBP) (P.L. 101-189).
>
> Our Association maintains a file of general information concerning the tax treatment of annuities such as RSFPP, SBP and SSBP for tax purposes by federal, state and local tax authorities. In addition, we post to our web site an annual tax article (2000 edition attached) which is available to our 396,000 members.
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> It would be appreciated if you would inform us whether or not RSFPP, SBP and SSBP annuity payments are subject to any of the following state taxes, if such taxes are imposed by your state, any applicable exemptions (monetary or other) and excerpts from applicable state tax law/statutes: (a) Income Tax, and (b) Estate Tax.

In your second letter you state:

> Our Association maintains a file of general information concerning the treatment of military retired pay (and the pay of uniformed personnel of the Public Health Service and National Oceanic and Atmospheric Administration) for income tax purposes by federal, state and local tax authorities. In addition, we post to our web site an annual tax article (2000 edition attached) which is available to our 396,000 members. In this respect, would you please

furnish the information (and excerpts from applicable state tax laws' statutes) indicated in the following questions:

1. Is military retired pay subject to your state income tax regardless of the reason for which a service member was retired? If so, what special exemptions, if any, are granted?

2. A person who is retired for military disability (as distinguished from non-disability retirement based on length of service) and has military pay based on percentage of disability must meet the following conditions for federal income tax exemption: (a) On or before September 24, 2995, the member was entitled to receive retired pay computed on the basis of percentage of disability; or (b) On September 24, 1975, he or she was a member of the armed forces (or Reserve component thereof) or under a binding written commitment to become such a member; or, (c) The member receives disability retired pay because of combat-related injury. The term combat-related injury or sickness means personal injury or sickness incurred as a direct result of armed conflict, or while engaged in extra hazardous service, or under conditions simulating war. (These conditions are codified in 26 U.S. Code, Section 104.) For people covered under a, b or c above, the tax exemption rules are further clarified as follows: (1) If military retired pay is based on the percentage or degree of disability or is paid under disability retirement laws in effect before October 1, 1949, the entire amount is exempt from income tax; (2) Where gross military retired pay is based on years of service (2.5 percent for each year), the amount payable solely on percentage of disability is tax exempt. The excess, as reported on Form 1099-R, is taxable income. For persons not covered by the previously specified eligibility criteria – that is, primarily persons who became members of the armed forces after September 24, 2975, and who do not receive disability retired pay because of a combat-related injury or who are not eligible for disability compensation administered by the Department of Veterans Affairs – amounts received as disability retired pay are fully subject to taxation. Is any portion of military disability retired pay exempt from state tax, such as on Federal returns? If so, what specific exemptions, if any, are granted?

3. What is the address and telephone number service members can use to obtain more detailed information and order tax forms?

4. What is your web site address?

5. Do you allow taxpayers to (a) file forms generated by computerized tax programs or (b) file electronically by modem?

6. Does your state use the Kansas/California method for taxing nonresidents – ascertaining what the member's tax rate would have been if all of his or her income had been taxable in the state and taxing the taxable portion at that rate?

7. Does your state permit separate returns even if a joint federal return is filed?

Discussion

Under the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 *et seq.*) an individual's Illinois net income is determined by starting with the amount of his or her federal adjusted gross income (AGI), then modifying that amount in accordance with specific addition and subtraction modifications. Thus, amounts not included in an individual's federal AGI, unless the subject of an Illinois statutory addition modification, are not subject to Illinois income tax. On the other hand, amounts included in a taxpayer's federal AGI are generally subject to Illinois income tax unless there is an applicable statutory subtraction provision.

Section 203(a)(2)(F) of the IITA provides a subtraction modification from federal adjusted gross income for all amounts included in a taxpayer's federal adjusted gross income ad distributions under "any retirement or disability plan for employees of any governmental agency or unit." This subtraction modification includes annuity payments under the FSFPP (Retired Serviceman's Family Protection Plan) and the SBP (Survivor Benefit Plan). Our review of the SSBP (Supplemental Survivor Benefit Plan) leads us to conclude that SSBP Payments would also be included within the scope of this subtraction modification. You should note that since these payments will not be subject to Illinois income taxation, they will also not be subject to Illinois income tax withholding.

The IITA contains no addition provision relating to amounts received as distributions from any retirement or disability plan for employees of any governmental agency or unit. As stated above, Section 203(a)(2)(F) in fact contains a subtraction modification for such payments. Illinois Income Tax Regulations extend the term "employee" the same meaning as under Internal Revenue Code (IRC) Section 3401(c) and Treasury Regulation 31.3401(c)-1 (86 Ill. Adm. Code 100.3100(b)). Section 3401(c) provides that the term employee includes an employee of the United States, or any agency or instrumentality thereof. Thus, the term employee for purposes of the IITA includes a member of the United States Armed Forces (and uniformed personnel of the Public Health Service and National Oceanic and Atmospheric Administration).

Military retired pay received pursuant to a retirement plan for members of the U.S. Armed Forces is therefore not subject to Illinois income tax, regardless of the reason for which the service member was retired. Likewise, any amount received as military disability retired pay pursuant to a disability plan for members of the U.S. Armed Forces is not subject to Illinois income tax.

The address and telephone number service members may use to obtain additional information is as follows:

Illinois Department of Revenue
Willard Ice Building
101 West Jefferson Street
P.O. Box 19044
Springfield, IL 62702

Telephone: 1-800-732-8866
217-782-3336
TDD 1-800-544-5304

The address and telephone number service members can use to obtain tax forms is as follows:

Illinois Department of Revenue
P.O. Box 19010
Springfield, IL 62702

Telephone: 1-800-356-6302

Your members may also submit a Form IDR-341, *Tax Information Request* to the Department to receive tax information such as the Illinois Package X, Illinois Fed-State Tax Review, informational bulletins and special notices. The form is available on the Department's web site, and the form contains the address where it is to be submitted.

The Illinois Department of Revenue's web site is: http://www.revenue.state.il.us/.

Computer-generated forms may be filed provided the Department has approved such forms. Form approval for software companies that provide computer-generated forms is given at the company level. Please be advised that many forms are available at the Department's web site listed above. There is also a list of approved alternate form providers on the Department's web site.

The Illinois Department of Revenue encourages eligible individuals to make use of electronic filing of certain Illinois income tax returns. The Regulations relating to electronic filing are found at 86 Ill. Adm. Code 105/100 *et seq.* (a copy of which is enclosed for your records).

Section 201(b)(3) of the IITA provides that the entire Illinois net income of an individual, including a nonresident individual, be taxed at a flat rate of three (3) percent. The Kansas/California method which you describe is therefore inapplicable to the determination of Illinois income tax.

Section 502(c)(2) requires, with one exception, that spouses filing a joint federal income tax return also file a joint Illinois income tax return. The one exception is found at IITA Section 502(c)(3). That section mandates the filing of separate Illinois income tax returns by spouses where only one of the spouses is a resident of Illinois, unless such spouses file an election to determine their joint net income and file a joint return as if both were residents.

As stated above, this is a GIL that does not constitute a statement of policy that applies, interprets orr prescribes the tax laws, and it is not binding upon the Department. If you are not under audit and you wish to obtain a Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Please do not hesitate to correspond with me further if you should have additional questions or require additional information.

Sincerely,

Matthew S. Crain
Associate Counsel ➢ Income Tax